

**Corporate Ethics and Compliance Programs:
How Can You Demonstrate
Their Effectiveness?**

by

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CORPORATE ETHICS AND COMPLIANCE PROGRAMS: HOW CAN YOU DEMONSTRATE THEIR EFFECTIVENESS?*

*Alan Greenwood and Steven Lauer***

I. Introduction

A recurrent task facing managers of ethics and compliance programs/1/ is to demonstrate the effectiveness of the programs that they manage to both internal and external audiences.

Since management commitment and support is the fundamental requirement for effective compliance programs, it is essential for ethics and compliance officers to successfully demonstrate program effectiveness in order to gain the trust and active support of internal audiences. Internal audiences who periodically conduct reviews of programs include senior corporate management, boards of directors, committees of boards of directors such as audit committees and corporate and social responsibility committees, as well as others concerned with the corporate governance process including internal auditors, legal staff, human resources staff, and ombudspersons. The external audiences include a greater number of distinct groups including regulators and other governmental officials, the investment community, and shareholders.

How does an ethics and compliance officer demonstrate its effectiveness? To answer that question, you must understand, among other things, the various audiences, why they represent important constituencies for the program, and their specific informational needs. Further, you need to map those needs against the program itself, as well as the business operations to which it relates.

II. Internal Constituencies

Which individuals or groups within the company represent important audiences for this message? In all likelihood, members of the board of directors, senior management, the finance function of the company, internal audit, and the law department have considerable interest in the functioning of the ethics and compliance program because of its impact or potential impact on their activities and responsibilities and the fortunes of the company.

The needs of those groups for information about the firm's ethics and compliance program will vary from company to company to a certain degree. Nonetheless, one can probably identify some commonalities about those needs and the data that would address those needs.

- ***Integration with Business Processes:*** Most management groups will look for assurance that the ethics and compliance program is properly integrated with the firm's business processes. An example of this is eliminating duplicate databases and reports by frequently auditing groups as well as ethics and compliance programs and by tracking cases and reports on the issues to see if there may be opportunities to integrate these reports rather than maintain separate "data islands." More broadly, management groups should be looking for evidence that the ethics and

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compliance program is truly integrated into the business processes; if it is divorced from those business operations, the organization cannot be confident that it truly has embedded a “culture of compliance.” Programs that are not integrated in this manner will not succeed in changing behavior or ensuring an ethical environment for decision making.^{/2/} For example, if the incentives by which employees are rewarded in the business are antithetical to the behavior intended by the ethics and compliance program, the former will succeed at the expense of the latter. This suggests that the effectiveness metrics^{/3/} must reflect the integration of the program with the firm’s business processes.

- ***Clearly Written Standards and Controls:*** Managers will want to be sure that the program includes unambiguous standards and clear protocols and controls.
- ***Effective Training and Communication:*** One must be prepared to demonstrate that the program has a practice communication process and, most importantly, an effective training program that covers all the risk areas within the scope of the organization’s operations.
- ***Regular Monitoring and Evaluation:*** Critical audiences can be expected to demand evidence that the program has appropriate monitoring measures in place, such as confidential reporting channels and help lines.

Business executives hope that each corporate initiative contributes, in a direct and positive way, to achieving the company’s objectives. While demonstrating such a positive correlation between compliance and the business objectives may prove difficult, one should attempt to devise measurements that can demonstrate whether and the degree to which the program does so.

What other measurements can be used to demonstrate the program’s effectiveness for the board and senior management? Clearly, the more you can demonstrate that the program accomplishes the objectives that the board set for it,^{/4/} the stronger their support for the program will be. Accordingly, look for tests by which to demonstrate how well the program meets their expectations. Keep in mind that every internal constituency will assess an ethics program by its impact on the aspect of governance of the organization for which that constituency has responsibility and, in every case, will need to be convinced that the program is an additive to and has the capability to increase the effectiveness of their efforts in this area.

III. External Constituencies

External audiences frequently have a sharper and more focused interest in an organization’s compliance program. In general, their fundamental bias — as should be the case — is one of a certain skepticism that can only be allayed by a highly professional demonstration that the company’s program has state-of-the-art tools to “detect and prevent wrongdoing.” The bases for their interest vary, however, so their data needs may also differ.

Government agencies and officials constitute one of the most significant audiences for companies’ compliance programs. Some agencies regulate specific industries and have the authority and interest to review the compliance programs of the companies in that industry or industries and even to mandate changes in those programs or requirements as to how the programs might operate. The U.S. Department of Health and Human Services, for example, oversees many health care industries and has developed guidance documents for firms on the elements and operation of a compliance program for those industries.^{/5/} Other agencies have broader missions. The SEC, for example, oversees the operation of the market for publicly traded securities and, in that context, reviews actions of corporations in many industries.^{/6/}

In addition to the government, other groups outside the company have an interest in its compliance program's operation for one reason or another. Some industries' trade associations or other groups have created compliance guidance for members of those industries, for example, and they monitor the operation of their members' programs as they do their members' conformity with ethical or other standards. In other instances, the trade associations do not monitor or regulate their members' adherence to such standards, but the standards themselves include good suggestions as to what an effective compliance program should include and, in fact, might constitute an even more definitive standard.^{7/}

Other external constituencies include the financial community, the insurance industry, and a corporation's shareholders.^{8/} While their needs may be similar, the specific provisions that they consider appropriate or desirable might vary.

The Health Care Compliance Association (HCCA)^{9/} serves as an excellent example of an organization that has developed specific guidance on compliance programs for that industry. HCCA worked with the Office of the Inspector General of the U.S. Department of Health and Human Services to explore the issues relevant to a compliance program for the health care industries and then, based in part on that collaboration, prepared "Evaluating and Improving a Compliance Program; A Resource for Health Care Board Members, Health Care Executives, and Compliance Officers" (Apr. 4, 2003).^{10/} In that document, HCCA described many factors relevant to the effective operation of a compliance program and described various methods by which to gauge that effectiveness.

After first establishing the foundation for a good compliance program,^{11/} HCCA addressed how to measure the program's effectiveness. "As a practical matter, and in order to create a starting point for efforts to improve the quality and efficiency of compliance programs, we believe that a compliance program can be evaluated by analyzing two dimensions: *effort* and *outcomes*."^{12/} For a more mature program, an improvement in outcomes represents a more significant measure of its effectiveness than does the firm's effort.^{13/}

Increasingly, virtually every industry association on the producer/supplier/provider side has developed programs and/or pronouncements for its members regarding standards or programs relative to ethics and compliance. Thus, it is essential to be more than conversant with such programs and to be able to demonstrate that your firm's program meets or exceeds the standards of that industry. Should it be the case that firms in the industry have recently encountered compliance or regulatory incidents or issues, then one can confidently predict that such areas or incidents are likely to be given special focus in any questions you will receive.

To summarize, you must identify the external constituencies whose views regarding the firm's compliance program carry weight. Having identified those constituencies, you need to understand the substantive and procedural criteria that those constituencies will apply and how those criteria are likely to be applied to your program. You must also be prepared to conduct a continuing dialogue with such groups so that the ethics and compliance officer has a healthy and respectful relationship with external groups affected by the company's program.

Finally, the process of presentation, demonstration, and dialogue about the scope, effectiveness, and reach of a company's ethics and compliance program has to be seen as part of a continuous cycle of review and improvement that is necessary to sustain an effective program.

IV. Using Technology to Demonstrate Effectiveness

In light of the need for a reliable demonstration of a compliance program's effectiveness, should an ethics and compliance officer look to technology for assistance? Yes, on several fronts.

First, technology can deliver to all or some of an organization's employees the training that constitutes such a critical component of any compliance program.^{/14/} That training is consistent and reliable. Other related material to assist the trainee to assimilate the learning can accompany the core training material.^{/15/} Systems that deliver Web-based training courses also provide the company with data on the employees' use of the system. Did they complete the courses required? Did they correctly answer questions based on the material in the courses? The system's ability to track employee usage provides a very compelling record that can demonstrate that the company's training was effectively delivered and retained.

Section 301 of the Sarbanes-Oxley Act of 2002 states that the audit committee of a company's board of directors must, as set out in that provision, "establish procedures for ... the receipt, retention, and treatment of complaints ... regarding accounting, internal accounting controls, or auditing matters; and ... the confidential, anonymous submission by employees ... of concerns regarding questionable accounting or auditing matters." Technology can assist ethics and compliance officers to satisfy that part of the law. Integrity Interactive's WebLine allows the anonymous submission of complaints and concerns about a wide variety of issues including those itemized in that provision of law. The individual who submits such a complaint can monitor how the company deals with the issue while remaining anonymous. The company, on the other hand, can track the treatment of each submission so as to develop data and metrics by which the board of directors and senior management can "be knowledgeable about the content and operation of the compliance and ethics program and ... exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program."^{/16/} A system such as WebLine can even produce reports that categorize complaints by subject, status, age of complaint, and other criteria.

When considering a technology solution for the company's compliance training needs, confirm that the system under consideration has at least the above capabilities. Anything less can prejudice the firm's ability not only to assure itself that it complies with law and policies, but its ability to demonstrate the effectiveness of its compliance program to its internal and external constituencies.

V. Summary

Creating a corporate compliance and ethics program constitutes only the first step in the effort. Making sure that the program works as planned — that it effectively reduces the likelihood that the company will violate laws, regulations, or policies — requires ongoing effort. Demonstrating that effectiveness to the myriad audiences that have an interest in that issue will prove a challenging task. By doing so, however, one can close the loop and assure that the program will gain increasing importance and vitality as it succeeds and attracts the institutional support that will enable it to survive and thrive.

With all of the changes and new mandates in the area of corporate ethics and compliance programs, the assistance of technology tools to demonstrate that the program is effective is invaluable. Evidence that more and more companies recognize the value of technology in this regard comes from a recent survey of Fortune 500 companies by *Corporate Counsel* magazine that found that 53 percent of Fortune 500 companies' law departments have determined to supply compliance training courses to the companies' employees online. This compares with only 25 percent that had expressed a similar intent only one year ago.

ENDNOTES

^{/1/} We use the term "ethics and compliance program," rather than simply "compliance program," so as to more closely reflect the approach expressed by the U.S. Sentencing Commission in the changes it adopted on April 8, 2004, to the Sentencing Guidelines for Organizational Defendants (the Sentencing Guidelines). See § 8B2.1(a) of the Sentencing Guidelines as added.

- /2/ “The more you can design ethics and compliance-related activities that build off activities that have independent, business-oriented purposes, the more successful that compliance program will be. For example, requiring that a duplicate copy of a document that is already prepared as part of a transaction be filed in a compliance-related repository is far better than expecting the business personnel to prepare an additional document solely for compliance purposes.” LaJoie & Lauer, “Business Ethics and Compliance — Establishing an Effective Program,” *Law. Brief*, Feb. 15, 2004, at 2, 4-5.
- /3/ Metrics constitute the means by which to demonstrate what is happening in an organization and how those events relate to other issues. “The goal of metrics is to provide a clearer understanding of the relationship between [what is needed from a corporate function] and [the] action [of that corporate function] than one can otherwise gain.” Lauer, “Measuring the Value of Metrics,” *Corp. Couns. Q.*, July 2000, at 50, 51.
- /4/ The need for support from the highest levels of the organization is clear from a variety of sources, such as the Sentencing Guidelines) and the U.S. Department of Justice’s statements as to what attributes characterize an effective compliance program. A company’s compliance program should be based on a resolution of the board of directors or an action of a comparable authority.
- /5/ The Office of Inspector General (OIG) of the U.S. Department of Health and Human Services has developed a series of such documents. That office also has conducted joint roundtable discussions with the health care industry regarding compliance programs, including how to evaluate their effectiveness. See <<http://oig.hhs.gov/fraud/docs/complianceguidance/roundpress.htm>>. OIG’s interest in the effectiveness of a company’s compliance program is apparent from its description of that exercise.
- /6/ The SEC also regulates the securities industry, of course, and in that capacity has a much narrower focus than the one described in the text.
- /7/ The U.S. Sentencing Commission, in the changes to the Sentencing Guidelines that it adopted on April 8, 2004, and sent to Congress, indicated that “in determining what specific actions are necessary to meet [the requirements set out in the Guidelines], factors that shall be considered include ... applicable industry practice.” Application note 2(A) to § 8B2.1. The development of a standard by an industry group such as HCCA might, in some circumstances, then, be very important and even mandatory.
- /8/ Some organizations have devised indices by which to measure a business’s relative quality regarding governance, and those indices are promoted to shareholders as valuable means by which to assess a company as an appropriate investment. See <www.issproxy.com/>.
- /9/ See HCCA’s Web site: <www.hcca-info.org/>.
- /10/ This report is available at the following Internet address: <www.hcca-info.org/content/navigationmenu/compliance_resources/evaluation_improvement/evaluation_improvement.htm>.
- /11/ “[A] compliance program is a **systematic process aimed at ensuring that the organization and its employees (and perhaps business partners) comply with applicable laws, regulations, and standards**. ... In a general sense, a compliance program has two basic components — **structural** and **substantive**.” “Evaluating and Improving a Compliance Program; A Resource for Health Care Board Members, Health Care Executives, and Compliance Officers” (Apr. 4, 2003), p. 5 (emphasis in original).
- /12/ *Id.* at 7.
- /13/ *Id.*
- /14/ The Sentencing Commission, in its April 8, 2004, changes to the Sentencing Guidelines, emphasized that effective training is not an optional element of a compliance program; rather, it’s a mandatory one. See § 8B2.1(b)(4)(A): “The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program ... by conducting effective training programs.” Other government officials recognize the central place of training in a corporate compliance program. “A critical element of an effective compliance program is a system of effective organization-wide training on compliance standards and procedures. In addition, there should be specific training on identified risk areas, such as claims development and submission, and marketing practices.” See page 8 of *Corporate Responsibility and Corporate Compliance: A Resource for Health Care Boards of Directors*, a publication of the OIG of the U.S. Department of Health and Human Services, which is posted at <<http://oig.hhs.gov/fraud/docs/complianceguidance/040203CorpRespRscceGuide.pdf>>.
- /15/ Each of Integrity Interactive’s courses, for example, allows the client company to link from the course to its policies and other materials on the same subject as the course, in addition to providing the trainee the name and contact information for a person to contact with additional questions.
- /16/ This is mandated by § 8B2.1(b)(2)(A) of the Sentencing Guidelines as changed by the Sentencing Commission on April 8, 2004.

